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From: [REDACTED]

Sent: Friday, May 30, 2014 14:24:03

To: [REDACTED]

Cc: [REDACTED]

Bcc:

Subject: RE: Penalty Question

We agree that the fair market value of the cash value life insurance policy in both scenarios is part of a reportable transaction understatement, and therefore the § 6662A penalty is properly applied against the amount that's included in income. We reach that conclusion because we believe it is appropriate to conclude that the omitted income was attributable to the transaction listed in Notice 2007-83.

The fair market value of the cash value life insurance policy is an item attributable to a listed transaction, and thus an item to which section 6662A applies. Sec. 6662A(b)(2). Because the taxpayer had never included the value of the benefit in income and the income results from a reportable transaction (even from an earlier year and even without any contribution in the year in issue), the inclusion in income is an "amount of the increase (if any) in taxable income which results from a difference between the proper tax treatment of an item to which this section applies and the taxpayer's treatment of such item (as shown on the taxpayer's return of tax)". Sec. 6662A(b)(1)(A). Accordingly, the section 6662A penalty is properly imposed on that additional income for the year of inclusion.

In the second scenario, because the taxpayer made a contribution and took a deduction in the year under exam, the taxpayer was participating in the transaction and thus had a disclosure obligation in that year; we have traditionally said that the taxpayer must report the deduction from the Notice 2007-83 transaction on their return to have a disclosure obligation. Accordingly, the 30-percent section 6662A penalty may apply to both the improperly deducted contribution and the includible portion of the cash value life insurance policy.

In the first scenario, however, the taxpayer did not claim a deduction from the transaction, did not participate in the year of inclusion, and does not have a disclosure obligation for that transaction in that year. Thus, only the 20-percent section 6662A penalty may apply.

Please let me know if you have any further questions.

Best,